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Correspondent of The National City Bank of New York

THE NATIONAL CITY BANK OF NEW YORK

Economic Conditions
Governmental Finance
United States Securities

1931

New York, August, 1931.

The European Financial Crisis

THE financial situation in Europe, rendered acute by the flight of capital from Germany and other Central European countries, has continued critical during the past month. The year's moratorium upon reparations and war debts proposed by President Hoover became operative July 6, subject to agreement upon certain minor details. Although this relieves Germany of the obligation to pay $400,000,000 abroad in the ensuing year, it does not solve all of her problems, the most pressing of which has been the withdrawal of foreign funds employed in the country and upon which German business is largely dependent.

The German situation was disturbed by the election of last September which weakened the position of the conservative Bruening ministry and caused a loss of about one billion reichsmarks ($250,000,000) from the gold and foreign exchange holdings of the Reichsbank. Of this, however, 800,000,000 reichsmarks ($200,000,000) was recovered by the end of 1930 and the situation remained with little further change until May, when the difficulties of the largest bank in Austria unsettled financial affairs throughout Central Europe. The troubles of the Vienna bank were primarily due to flight of foreign funds, and the publicity given to that situation undoubtedly affected the situation in Germany. The plain language of the decree issued by the German government early in June, telling of the pressing necessity for further economies in the administration and for additional taxation, while intended for internal influence, doubtless had an effect abroad, and the loss of gold and exchange became so important that President Hoover, who was keeping well-informed upon the situation, on June 20 issued his proposal. This had an almost electrical effect, but with the delay in negotiations and the increase of publicity and excitement, the demand on the Reichsbank for the conversion of funds into gold and foreign exchange was renewed, and extended to demands upon the banks generally for currency. On July 13 the Government took the situation in hand by closing all banks, excepting the Reichsbank, for two days. Limitations as to withdrawals except for payrolls and other necessary purposes have since been enforced, and the Reichsbank, which was given control over foreign exchange transactions, has placed certain restrictions upon sales of exchange.

Conferences have been held in Paris and London, participated in by officials representing the governments of Germany, the countries interested in reparations, and the United States, but these parties were not prepared to agree upon anything beyond the one year moratorium already concluded and an expression of opinion that the banking authorities of the world should attend to the need for ready money.

Germany, feeling keenly the weakness of a position dependent upon short-term loans, has urged the flotation of a long-term loan of as much as $500,000,000, but this has not been considered practicable in view of the present market price of the last German loan. However, an appreciation of the importance to the whole world of preventing a collapse of the German economic system has prompted foreign bankers who still have loans in Germany to agree tentatively not to withdraw these funds at present and to pursue a common policy regarding them.

This understanding seems to have been sufficiently inclusive, together with efforts at self help which have been made, to hold the situation fairly stable to this time, although the state of uncertainty unquestionably is harmful to business not only within Germany but everywhere.

Background of the Present Situation

In the July issue of this Letter we described at some length the principal causes leading up to the present difficulties. These date back to the war and the conditions of peace imposed by the Treaty of Versailles.

A first of these original causes has to do with the partition of territory effected by the peace

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treaty. By this treaty Central Europe was broken up into a larger number of smaller states, with all the resultant obstacles to trade that proceed from the multiplication of national boundaries and tariffs. In this partition of territory Austria suffered the most. Vienna, its capital and a city which before the war had been the financial and commercial capital of Southeastern Europe, was deprived of most of its supporting country. Due to this handicap, Vienna has had an uncertain and difficult time ever since the war, and twice during the past five years the Credit Anstalt, the leading bank heretofore referred to, was forced to take over other important banks in that city in order to support the credit situation. That a situation so inherently weak even in normal times should prove unable to stand the strain of a severe and prolonged depression is not surprising.

A second of these original causes has to do with the shortage of domestic short term capital in Central Europe, caused partly by the need for making reparations payments, but largely by the war and the depreciation of currencies that followed the war. In the absence of home supplies of capital, these countries, and particularly Germany, turned to foreign countries and borrowed large amounts, the total of long term borrowings of Germany alone from the United States, including direct investments, approximating $3,300,000,000 in the period between the currency stabilization in 1924 and 1930. Large as these borrowings were they were still insufficient to supply German capital requirements, so that interest rates continued high and induced a heavy inflow of foreign short term credits, especially from England and the United States. By the end of 1930 it was estimated that the total amount of foreign short term credit employed in Germany was in the neighborhood of 11 billion reichsmarks. Thus, the German credit structure became largely dependent upon a volume of foreign credit subject to withdrawal upon comparatively short notice, and a like situation prevailed elsewhere in Central Europe.

Still a third factor out of the past which has tended to aggravate the present crisis has been the memory of the great inflation, when the mark and other Central European currencies became practically worthless. This memory of past losses has made the people of these countries quick to distrust their own currencies and induced a flight of capital by domestic owners which has been a factor in the crisis along with the withdrawal of foreign credits.

The instinct of self-protection is strong in an individual. He does not definitely know what others are doing, but is surrounded by alarms. While he may have a patriotic inclination to co-operate with the public authorities in their policies, in the absence of organization he is likely to feel that the contribution which he can possibly make, while much to him and his dependents, is of small importance in the general situation. Hence the necessity for the action which the government has now taken to control the sale of foreign exchange.

At this point it is desirable to interject that American banks have been unjustly blamed in connection with the flight from the mark. Though an almost universal impression seems to prevail that the crisis in June was precipitated largely by the withdrawals of American credits, a comprehensive survey conducted among the banks in principal cities of this country has shown that the volume of their credits outstanding to Germany underwent almost no shrinkage during the month.

Measures to Support the Situation

Significant action was taken July 8 by a body of financial and industrial leaders of Germany to support the Reichsbank by a pledge of their private credit given to its subsidiary, the Gold Discount Bank. A joint letter addressed to the President of the Reichsbank stated that under leadership of the Gold Discount Bank "a guaranty syndicate will be formed, consisting of German industrial, banking, shipping, and commercial organizations which will assume a collateral guaranty to the extent of 500,000,000 marks in order to strengthen, through this guaranty sum, the power of action of the Gold Discount Bank." Such action is well calculated to inspire confidence. On the strength of it the Gold Discount Bank has exercised a sleeping option which it had held for some time for a $50,000,000 credit in the United States.

A plan to give greater liquidity to the situation includes the organization of a new "Acceptance and Guaranty Bank" in Berlin, in which all of the leading banks, including the Reichsbank, will be shareholders. It will have a capital of 200,000,000 reichsmarks (about $47,000,000) and its special function will be to facilitate the discounting of paper for the smaller banking institutions, which perform an important function and have been embarrassed by present conditions.

The credit of $100,000,000 which was granted to the Reichsbank in June by the Bank for International Settlements, Bank of England, Bank of France and Federal Reserve Banks has been extended.

The restrictions placed upon currency payments by the banks naturally have had the effect of preventing the usual return flow of currency to the banks. What they pay out tends to stay out, increasing the aggregate nominally in circulation, thus affecting the re-

serve percentage of the Reichsbank. On the other hand, the restrictions upon sales of foreign exchange will tend to build up the foreign exchange holdings so that on the whole the aggregate reserves will be maintained. Legal action has been taken reducing the required reserve in both gold and foreign exchange from 40 per cent to 30 per cent. The actual ratio as shown by the statement of July 23 was 36 per cent.

A decree has been issued requiring all business houses to report to the Reichsbank the amount of whatever foreign cash credits they possess in excess of 50,000 reichsmarks. This for the purpose of learning what resources of this kind are available.

The situation in Germany has differed from an ordinary run upon banks in that it was primarily a run on the gold and foreign exchange resources of the country. The Darmstaedter und National Bank, one of the principal banks of Berlin, and one which possessed the confidence of the public, suspended payments on July 13. Jacob Goldschmidt, the active head of the institution, in a public statement said that foreign funds equivalent in amount to nearly $500,000,000 had been withdrawn from the country within the preceding two and one-half months, and that about one-third had to be provided by the Darmstaedter bank. The total accounts payable of the bank at its closing were approximately $375,000,000. In order to quiet alarm the national government promptly guaranteed full payment of the bank's obligations.

As will be readily seen, the danger of the situation is in the difficulty of organizing the economic strength of Germany to withstand the rapid withdrawal of liquid capital which is almost indispensable to her industrial life. In the absence of adequate offerings of long-term investment capital in the last three years, the country has taken the only kind available, to wit, short-term offerings. Nevertheless, it was making headway, despite high interest rates, until the world-wide depression came. With hard times have come political agitation, as in other countries, and both political and economic confusion. Germany is essentially sound economically, and if the leaders can have the united support of the people will come through this crisis successfully. The terrible experience with currency inflation which that country passed through only a few years ago makes it reasonably certain that the people will prefer any alternative policy to a repetition of that. This is one good reason for believing that the Bruening government will be maintained, rather than that any coalition of doubtful financial policies will be voted into power. There is good reason to believe that with a demonstration of firm control confidence will grow from week to week and an increasing amount of funds become available.

The outcome is of great importance in world affairs, for if Germany can stay on her feet financially and maintain social order, the way back to prosperity will be easier in all countries. No country can be a gainer by a collapse of the credit and industrial structure of Germany. There could be no more conclusive demonstration than is afforded by the present situation of the fundamental interdependence of the modern world and the bounden duty of all in authority to work together for a solution that will make for lasting peace and cooperation.

A Committee of Inquiry

Among the resolutions adopted by the seven-power conference of government representatives in London, beginning July 20, one of the most important reads as follows:

> The conference recommends that the Bank for International Settlements should be invited to set up without delay a committee of representatives nominated by the governors of the central banks interested to inquire into the immediate further credit needs of Germany and to study the possibilities of converting a portion of the short-time credits into long-term credits.

The resolution has two objects: (1) to set up without delay a committee to inquire into the immediate further credit needs of Germany, and (2) to study the possibilities of converting a portion of the short term credits into long-term credits.

The Committee named consists of Messrs. Layton, Great Britain; Moreau, France; Melchior, Germany; Beneduce, Italy; Francqui, Belgium; Bindschedler, Switzerland; Tanaka, Japan; Rydbek, Sweden; ter Meulen, Holland; and Albert H. Wiggin, of the Chase National Bank of New York. The appointment of this Committee for the purpose in view undoubtedly will have a helpful influence upon sentiment and in bringing about a better understanding of the short-term credit situation.

Under existing conditions the German problem clearly is that of maintaining short-term credits rather than of obtaining conversion into long-term obligations. In view of the prices now prevailing for German bonds in all markets the suggestion of long-term credits must be regarded as impracticable until the credit status of Germany is more definitely established. It is hardly to be supposed that new long-term credits can be negotiated which will be subordinate to the obligation to make reparations payments. When the first German loan was floated under the Dawes plan, for the purpose of providing funds for establishing the new Reichsbank and currency system, the bonds were made "a specific first charge on all payments provided for under the Plan of the Dawes Committee to or for the

account of the Agent-General for Reparation Payments, such charge being prior to reparation and other treaty payments."

Drain on the Bank of England

One of the most remarkable features of the European situation, and one which well illustrates how one situation reacts upon another, has been the sudden drop in sterling exchange, which made it possible to take gold from London to almost any other financial center outside of Central Europe. The high point of Bank of England holdings this year was reached on July 6, when they stood at approximately $807,000,000. On July 15, two days after the bank crisis in Berlin, sterling exchange made a spectacular break, to $4.83 1/16, far below the point at which gold normally moves to New York ($4.84 13/16). At the same time the French franc moved upward, almost touching the gold export point in New York and going much above the export point in London. The latter situation continued throughout that week and the week ended July 25, and gold moved to Paris in amounts beyond any precedent. On July 23 the Bank of England discount rate was raised from 2½ to 3½ per cent, but the loss of gold continued over the following week end. On July 30, although the movement had been reduced to comparatively small proportions, the Bank took the further step of raising the discount rate to 4½ per cent. The loss of gold was shown by the July 30 statement of the Bank of England at $158,000,000, reducing the Bank's holdings to $649,000,000 (£133,309,000).

It is of course the usual procedure for a Central Bank which is losing gold in what seems to be a movement of more than ordinary importance to raise its discount rate, and the Bank of England has long followed the practice of raising the rate by a full one per cent. Therefore its action under the circumstances is not to be regarded as extraordinary. Reports have been current that it was arranging for credits at the Bank of France and the Reserve Bank of New York and doubtless it could obtain them at either place if they were desired. Thus far it has preferred to handle the situation within its own resources.

Although the exchange rate on New York remained for about a week below the gold point at which shipments could be made at a profit, no shipment was made, New York bankers declining the opportunity on the ground that it was undesirable that gold should be taken from London under existing circumstances.

What prompted the heavy movement to Paris can be only surmised. The Bank of France was not a party to it and it is said that leading French private banks have been willing to join the Bank of France in a credit to the Bank of England to offset the movement. The presumption is that the movement had its initiative in a desire on the part of certain French banks to strengthen themselves on account of alarms on the Continent. The French money market has a great plethora of funds.

Rediscount Rates

The following table gives rediscount rates at the central banks named on the dates given, showing the effect of the disturbance from the end of May to July 30.

	Rediscount rates in force at the end of May 1931	at present
England	2½	4½
Germany	5	10
Ireland	3½	4½
Austria	5	10
Hungary	5½	9
Yugoslavia	5½	7½
Spain	6	6½
Danzig	5	7
Sweden	3	4

These changes show the effect of abnormal influences. They do not prove, as some persons may fancy, that the world should not have a common standard of value, or that there is not gold enough to go around. The world adjusts itself to business methods suited to normal conditions, and to reserves suited to normal conditions. Business left to itself will maintain its equilibrium very well. War, peace settlements, political and social agitation, matters wholly unconnected with ordinary industry, trade and banking, are responsible for these disturbing events.

General Business Conditions

In this country, the German crisis has had a restraining effect upon hopes that Autumn business expansion might be more rapid or greater than usual. Germany is the third largest buyer of American goods, and the effects of her difficulties in varying ways and degrees extend over the world. There is no reason to fear that business revival will be compelled to wait for complete removal of all the obstacles opposed to it, for necessities must be supplied and trade goes on despite handicaps and over barriers, and the millennium of a perfectly organized world whose people always behave rationally is not within reach. Nevertheless, the month's foreign news offers disappointing evidence of the seriousness of the difficulties which remain to be dealt with, after nearly two years of depression, and of the problems to be solved in restoring world trade and international capital movements to normal.

Under this sobering view of world conditions the stimulus given to the markets by the moratorium proposal has been largely lost

during July, and business has been generally dull. The filling of necessary needs for articles of everyday use enables the industries which supply those wants to make a good showing. In shoes, woolens, silks, rayon, cotton goods and tires production has come a long way from the bottom, and has been running larger than a year ago. Among the major industries these are the chief support of business, both as to volume and profit, at the present time. The heavy industries, however, are down, and the amount of their contribution to the business total is so great that the composite seasonally adjusted indexes which measure activity have declined, after due allowance for the usual summer recession. Some have found a new statistical bottom for the depression, below even their December-January level.

The Record of the Indexes

The following table presents the Winter low of several of the indexes, and the peak of the subsequent recovery, contrasted with the June figure, the latest available:

Index		Winter Low	April Peak	June
Federal Reserve Board	Jan.	82	90	86
Standard Statistics Co.	Dec.	70.3	76.5	69.0
Brookmire	Jan.	73.4	77.7	71.9
Annalist	Jan.	74.4	80.8	76.5

Preliminary indications are against improvement of these indexes in July, in view of the further falling off in steel, automobiles and building.

The course of business thus illustrated is evidence of a waiting attitude on the part of business men this Summer, and of conservatism in speculating upon future possibilities. The dullness of the stock market, in which trading has dropped to the lowest volume since 1924, points in the same direction. This is a rational policy under the circumstances; it has reduced volume but has kept stocks down, and is hopeful for the future. That the period is one of progress in increasing efficiency and reducing costs is common testimony, and is supported by the report of profits of industrial corporations which appears subsequently in this Letter. Few individuals have it in their power to do anything more useful in the situation, and this progress will eventually prove the most important factor in restoring equilibrium, and will reap commensurate benefits when business expands again.

Commodity price indexes in several cases made new lows toward the end of July, erasing another of the false starts upward which they have made during the depression. However, the declines have lacked the uniformity of earlier months, and weakness in the position of some staples is offset by improvement in others. If, despite irregularity during the Summer, prices of raw materials hold a general sidewise trend their steadiness should materially assist Fall recovery as well as relieve the pressure upon holders whose margins have been worn thin.

The chief obstacle to early price gains is the disorder in world business, which is compelling debtor countries everywhere to try to sell more and buy less in order to convert unfavorable trade balances into favorable ones. Though that is the way back to sound economy for themselves, such tendencies create problems for this and other countries which require export outlets for surplus products. During June our merchandise exports totaled only $187,000,000, the lowest in any month since September 1914, and a decline of 36 per cent as compared with June a year ago. Imports of $176,000,000 were the lowest in a similar period except for last February, and the excess of exports was only $11,000,000.

The Industries

The decline in steel mill operations flattened out toward the end of July, and the latest report shows the first increase in activity in any week since March. The average rate during the month has been little, if any, above 30 per cent, and while hope of important recovery prior to September is not generally entertained it is apparent that such a rate must represent nearly the absolute minimum of the country's requirements for steel. Individual structural awards from time to time have been quite heavy and supply the chief backlog of orders. Advancing prices for scrap, a commodity that is frequently barometric, are a favorable sign.

The F. W. Dodge Corporation, statisticians for the building trade, estimates that awards of contracts during the third quarter will not be more than 20 per cent under last year, making a better showing than in the first half when the decline was 31.4 per cent. However, this estimate holds little promise of expansion, the more favorable comparison being due to the falling off in 1930.

The decline in automobile production from the seasonal peak reached in May has continued, and although some companies report sales and output greater than a year ago, tentative indications are that the July ouput in the United States will show a drop of perhaps 20 per cent below July, 1930, and of about 15 per cent under June, whose 249,462 cars and trucks was in turn 21 per cent under May. August production will be further reduced by curtailment in Ford plants, and will doubtless fall much below sales for the month, reducing stocks at the opening of the Fall season.

Sales in the primary textile markets have been seasonably dull, but the cotton mills entered July in a greatly improved position

as a result of the buying spurt in June, and at the end of that month their unfilled orders exceeded stocks on hand by nearly a week's production. The usual Fall buying is expected to begin in August, and a continued higher rate of operation than in the third quarter of 1930 may fairly be expected. The woolen industry is making an exceptional showing for a time of depression, and shoe production during the between-seasons' period was maintained at a high level. The June output of 27,000,000 pairs compares with 23,900,000 in the same month last year, and many factories have now begun work on Fall orders. The showing in this industry is one of the bright spots of the year, and evidences the inevitable rebound after a period of underconsumption.

The Break in Oil Prices

The most extreme price weakness developed during the depression has occurred in crude petroleum, and is not principally due to business recession, but to the unrestricted flood of oil poured upon the market by the rapid exploitation of the new field in East Texas. At the beginning of this year, the situation in crude oil appeared more satisfactory than in some time. After three years of effort to keep down the surplus by proration of output, reasonable success seemed achieved. Daily average production, which during the first half of 1930 had been around 2,600,000 barrels, had been brought down to about 2,100,000.

However, hopes that the situation was in hand proved short-lived. All attempts at control in East Texas were rendered ineffective by the speed of drilling, and though most operators realized that market demoralization was inevitable, all had to join the rush of the few in order to get their oil to the surface before their neighbors could tap it. Since the first of March the country's daily output has risen sharply, exceeding 2,500,000 barrels again, due solely to East Texas, which in that period has jumped from about 10,000 daily to over 500,000.

Dumping of this oil produced during the past month a state of price competition rarely witnessed, culminating in a range of 10 to 22 cents for the posted price in the Mid-Continent, which compared with $1.23 for high grade oil a year ago and a high of $3.50 in January, 1921. The bare lifting cost, for pumping wells, could not be recovered at such prices; the full cost of production in the six Mid-Continent States in 1927-29, according to the Tariff Commission's investigation, was $1.06 to $1.10. Shutdown of a vast number of wells, even at risk of permanent loss of their oil, occurred so promptly that local shortages developed, with the result that prices outside of East Texas were raised again to a range of 27 to 50 cents toward the end of the month. Meanwhile the Texas problem is unsolved. The difficulties of an industry compelled to operate under such price declines are great, though the day will doubtless come when the refining companies will be able to make compensating profits out of the low-priced crudes they are now obtaining.

The East Texas field is the largest in surface area ever discovered. It is estimated that 6,000 wells may operate there in the future, possibly as early as 1932 if no check is placed upon them, against about 1,200 drilled up to the present. Unit operation, the pooling of acreage for joint development with division of the proceeds according to the equities of ownership, has been out of the question, and the contrast is striking to the efficient and orderly opening up of fields where by reason of control being in fewer hands that plan has been practicable.

The most reassuring aspect of the situation is that the surplus is localized. For the country as a whole, during the five months ended with May, nearly 10,000,000 barrels of crude and refined oil were withdrawn from storage, making a total reduction of 44,500,000 from the 1930 peak reached in March. The refining and marketing branch of the industry has kept inventories in good order, while the producing end must continue to sit upon a volcano of oil, whose eruption can be effectively prevented under present conditions only by unprofitably low prices.

Retail Trade

July and August are invariably the slowest months of the year in retail trade, and the seasonal decline has been evident this year as usual. However, the volume of goods sold by the only stores for which figures are available—department and chain stores—has continued to run well ahead of last year, to judge by preliminary reports, though dollar sales have been smaller.

Figures of these stores for June were quite favorable, and were the most cheering among the major trade indexes for the month. The Federal Reserve Board reports a decline of only 3 per cent in department store dollar sales as compared with June, 1930, and sales of 47 chains dropped only 2.28 per cent. Estimating that prices average fully 15 per cent lower, the increase in volume of business works out about 15 per cent. Reports of tonnage sales issued by certain chains generally support this calculation.

That all retail distributors are enjoying as good a business as these groups of course could not be contended. Retail insolvencies during this depression have been very heavy, and in the first half of this year numbered 10,038 according to Bradstreet's.

The success of many department and chain store organizations in selling increased quantities of merchandise in a year of depression has undoubtedly been achieved by passing on to consumers the benefit of lowered prices, and is suggestive of the stimulation to recovery to be derived from maintaining a balance between prices of materials and finished products. The most important factor in making it possible to pass on price reductions quickly is the efficiency of the distributing system, and it is significant that those merchandising agencies which commonly operate on the lowest gross margins and turn over their stocks most rapidly have been winning an increasing share of trade in these times, when economy is the first consideration of so many people. The depression is exposing the weak and strong points of the distributing system, and thereby speeding the development of a more efficient one.

Chains vs. Independent Stores

The present evolution in merchandising methods is viewed by many as a struggle between chains and independent stores. In that the former represent the newer method and the latter the older, this view is a correct one, but the progress made is not confined to either group, and while the chains have been leaders in setting higher standards of performance there is evidence to show that many independents are approximating those standards.

As regards store operation alone, the chain enjoys no advantage not open to alert independents. The chief economies of the chain come from the closer union of the buying, wholesaling and retailing functions, permitting reduction of selling expense, closer control of stocks, and substitution of fewer large orders for many small ones. Along that line independents likewise have made great progress through the so-called "voluntary chains," which in the grocery field have enjoyed such an astonishing growth in the past three or four years that they now operate more stores than the regular chains. The voluntary chains consist of cooperative buying associations of retailers, and of unions of retailers with wholesalers either through close working arrangements or outright ownership of the wholesaler. The American Institute of Food Distribution has records of 551 of these chains with 59,640 retail members, which compares with an estimated 55,000 to 57,000 stores for the regular chains. Figures of the operating costs of voluntary chains are not generally available, but in a recent speech the head of the largest of them, the Independent Grocers' Alliance, which is exceeded in volume of sales only by the Great Atlantic & Pacific Tea Company, said, "I.G.A. retailers on the average have reduced costs of operation from 17½ per cent to 20 per cent of sales down to under 11 per cent. Some are down to 6 per cent and 7 per cent. We have every reason to believe that the average will soon be well under 10 per cent."

These are figures of the retailing cost only, and the total cost of the wholesale and retail function is not given.

Harvard Bureau's Studies of Costs

Comparing the regular chain with the independent store, the Harvard Bureau of Business Research, in a recent study, concludes that the typical chain grocery companies in 1929, to cover their expenses and their profits, took out of the consumer's dollar approximately 7.7 cents less, in the case of the larger chains, and 8.8 cents less, in the whole group, than did typical wholesale and retail grocers together. The respective gross margins are: Typical chain, 19.4 per cent of sales; large chain, 20.5; wholesaler-retailer, 28.2 (18.5 for the retailer and 9.7 for the wholesaler). Of the chains' advantage it is estimated that nearly half results from elimination or substantial reduction of credit and delivery services. Probably an additional quarter is derived from carrying fewer items in stock than do the better grade independent service stores.

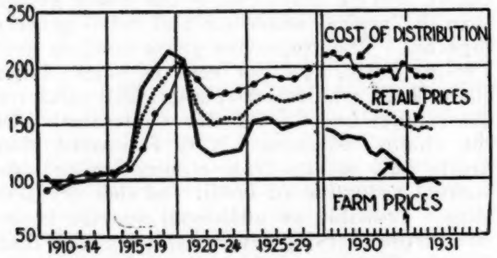
Translated into prices, the cash-and-carry chain gets $1.26 for goods costing a dollar, and the service independent, buying through wholesalers, gets $1.39 for goods costing a dollar. The chain has an advantage of about 11 per cent. And out of four actual field studies of comparative prices of branded items recently made under university auspices, three showed chain prices to be still lower.

However, store operating expense figures of the more efficient independents, taken alone, make a better showing than the foregoing when compared with the chains. The Progressive Grocer, a trade magazine, reports that a group of efficient cash stores surveyed operated at an expense of 10.7 per cent of sales and profit of 4 per cent, a total of 14.7; service stores' expense was 13.8 per cent and profit 4 per cent, a total of 17.8. The corresponding figures of the Harvard Survey for the typical chains were 12.0 expense and 1.9 profit (from both wholesaling and retailing), a total of 13.9.

The independent can buy some merchandise directly from producers as cheaply as the chains, except those which are producers themselves. Where in addition he buys staples from an efficient wholesaler, he can and does meet chain prices; or he offers credit, delivery service and greater variety of goods at the necessarily higher cost.

The Service of Distribution

Cost of distribution is a much considered question in this country, and rightly so. The New York State College of Agriculture at Cornell University publishes monthly an index of the prices paid to the American farmer for certain foods, the prices paid at retail for the same foods, both based on Bureau of Labor Statistics figures, and the cost of distributing food, according to its own studies. The accompanying chart (1910-14 = 100) shows the great spread of these figures since the war and suggests the benefit to be derived from reducing it, while the decline from the peak of 209 in distributing cost reached in April, 1930, to 192 for the same month this year, is at least encouraging, and offers hope of further progress.



Food Prices and Distribution Costs

Following the crash of prices of 1920, farm prices fell most of all, retail prices next and distribution cost comparatively little. From 1922 to the early months of 1930 distribution cost was rising.

Much comment upon distribution cost is made by persons who are not fully acquainted with the conditions and risks involved, and who take the view that an unnecessary share of it is a kind of predatory toll exacted from producer and consumer. The fact is that a rising cost of distribution is not necessarily a measure of inefficiency of distribution agencies in any way, but may be simply an indication of the increasing complexity of the business and social organization, and of the rise in wages, which are the greatest item in most distribution expense.

In the April number of this publication comment was made upon the statement often heard that the purchasing power of industrial wages since 1919 has not kept pace with the increase of productivity per worker in the industries. This admitted fact has been interpreted as proof that the industries have been making larger profits and the argument has been deduced that the depression came because the industrial workers did not have wages enough to buy their products. The error of this theory is largely in not taking account of the distribution costs which intervene between production and consumption, and which since 1922 have been relatively higher than either production costs or retail prices. Wages throughout the distributive organization, which includes all transportation, trade and incidental services, advanced along with wages in the industries, and in retail trade the offsetting economies have been less than in manufacturing. Hence the relative increase of distribution costs. Retail prices are on a lower level than distribution costs because of the fall of producers' prices.

In the handcraft days when communities produced most of the things they used, the cost of distribution was negligible, but in the more efficient specialized organization, which adds to the general wealth by increasing the quantity and variety of production, an involved interchange of goods is necessitated. Varied raw materials are brought together from distant points, and redistributed in finished form over a greater area, and the service of more labor and capital is required. Furthermore, distribution must be reasonably profitable, or too few men and too little capital will engage in it. Elimination of the middleman is an attractive-sounding phrase, but it cannot be carried to the extent of eliminating the service he performs except by returning to a state of individual self-sufficiency, which is neither possible nor desired.

In frequent instances, a higher cost of distribution has been incurred in order to enlarge the market, which has assisted in reducing manufacturing cost so that the final price of the article to the consumer is now less than would otherwise be possible; but it is equally true that in many lines distribution costs have absorbed production economies, and are recognized by leading industries as the most important problem in their progress toward greater efficiency and cost reduction.

The best way to achieve lower costs is to allow all newcomers with new ideas and new methods to engage in free competition with existing distributors, in order that the service may be performed by the most efficient men and methods available, waste reduced to a minimum, and the savings therefrom made available for the purchase of additional goods, raising the standard of living.

The Half Year's Profits

During the past month a large number of corporate earnings reports have been issued covering the first half year In view of the low level of business activity and the continued decline in commodity prices, it was a foregone conclusion that the showing would make an unfavorable comparison with the corresponding period of any preceding year as far back as 1921. Aggregate net profits, after

INDUSTRIAL CORPORATION PROFITS FOR FIRST HALF YEAR

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Half Year 1930	Net Profits Half Year 1931	Per Cent Change	Net Worth January 1 1930	Net Worth January 1 1931	Per Cent Change	Annual Rate of Return Per Cent 1930	Annual Rate of Return Per Cent 1931
4	Amusements	$ 9,551	$ 8,267	—13.5	$162,497	$185,585	+14.2	11.8	8.9
11	Apparel	2,386	541	—77.3	99,526	79,812	—19.8	4.8	1.4
1	Auto—General Motors	104,885	84,122	—19.8	954,476	966,802	+ 1.3	22.0	17.4
12	Auto—Other	17,240	8,344	—51.6	540,892	479,672	—11.2	6.4	3.5
24	Auto Accessories	13,907	6,111	—56.1	267,812	254,064	— 5.1	10.4	4.8
7	Baking	20,523	17,944	—12.6	318,409	317,576	— 0.3	12.9	11.3
13	Building Materials	9,154	4,647	—49.2	224,985	237,002	+ 5.1	8.1	3.9
16	Chemicals	65,734	48,656	—26.0	985,080	1,075,453	+ 9.2	13.3	9.0
8	Coal Mining	1,876	1,622	—13.5	123,937	124,462	+ 0.4	3.0	2.6
7	Drugs and Sundries	20,583	20,174	— 2.0	186,738	217,527	+16.5	22.0	18.5
9	Electrical Equipment	40,404	19,934	—50.7	738,699	741,714	+ 0.4	10.9	5.4
22	Food Products—Misc.	66,877	48,571	—27.4	749,144	783,720	+ 4.6	17.9	12.4
12	Household Goods	8,030	6,164	—23.2	168,835	173,071	+ 2.4	9.5	7.1
1	Iron and Steel—U. S. Steel	67,905	14,156	—79.2	1,919,313	2,059,089	+ 7.3	7.1	1.3
20	Iron and Steel—Other	47,684	719	—98.5	1,585,749	1,564,633	— 1.3	6.0	0.1
17	Machinery	15,870	5,026	—68.3	256,678	253,137	— 1.4	12.4	4.0
15	Merchandising	6,127	8,694	+29.5*	429,625	406,383	— 5.4	2.9	4.3
9	Mining—Non-ferrous	6,087	360	—94.1	186,205	179,074	— 3.8	6.5	0.4
3	Office Equipment	7,686	5,369	—30.1	113,155	115,799	+ 2.3	13.6	9.3
9	Paper Products	6,154	4,315	—29.9	276,513	295,750	+ 6.5	4.5	2.9
9	Petroleum	25,672	D-1,219	....	639,773	615,171	— 3.8	8.0	....
7	Printing and Publishing	17,500	10,698	—38.9	121,190	122,030	+ 0.7	28.9	17.5
7	Railway Equipment	14,110	2,583	—81.7	311,113	324,536	+ 4.1	9.1	1.6
3	Realty	4,415	852	—80.7	87,918	83,854	— 4.6	10.0	2.0
6	Restaurant Chains	3,835	3,271	—14.7	73,767	75,080	+ 1.7	10.4	8.7
5	Shoes	9,863	6,763	—31.4	182,330	179,888	— 1.3	10.8	7.5
11	Textiles	3,038	2,238	—26.3	156,054	147,927	— 5.2	3.9	3.0
6	Tobacco (Cigars)	4,002	3,038	—24.1	87,923	88,108	+ 0.2	9.1	6.9
51	Miscellaneous	17,938	10,974	—38.8	787,704	733,055	— 6.9	4.6	3.0
325	Total	$639,036	$352,934	—44.8	$12,736,040	$12,879,974	+ 1.1	10.0	5.5

* Gain largely due to two companies.

D—Deficit

all charges but before dividends, of 325 industrial and merchandising corporations whose reports have been tabulated and are summarized in the accompanying table, amounted to approximately $353,000,000 in the first six months of the current year, as compared with $639,000,000 in the first half of 1930, representing a decline of 45 per cent. Compared with the record year 1929, the decline was 62 per cent.

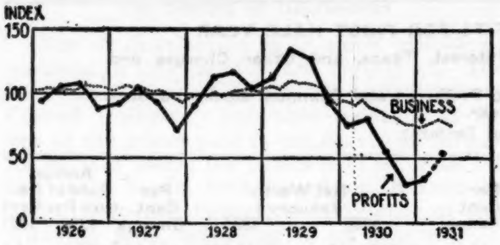
Our tabulation shows, in addition to the comparative profits in thousands of dollars, and the percentage change classified by major industrial groups, the "net worth" or capital stock and surplus account as given on the balance sheets at the beginning of the past two years, together with the percentage return calculated at an annual rate without allowance for seasonal variation. In the first half of 1929 the profits return was at the annual rate of 14.8 per cent on net worth, in 1930 at 10.0 per cent, and this year at 5.5 per cent.

Separate figures for quarterly earnings are available for approximately three-fourths of the companies, and these show that the decline as compared with the corresponding period of 1930 was considerably less in the second quarter than in the first. Combined net profits, less deficits, for the companies reporting quarterly, are as follows:

	1930 (000's Omitted)	1931	Per Cent Change
First Quarter	$269,425	$132,759	—50.7
Second Quarter	280,440	174,279	—37.9
Half Year	$549,865	$307,038	—44.2

Based on reports so far issued, the increase in second quarter profits over the first quarter this year was more than seasonal, amounting to 31 per cent. Last year the increase was only 4 per cent and in the preceding five years, 1925-29, the increase ranged from 13 to 23 per cent, averaging 19 per cent.

The accompanying chart shows the marked fluctuations that have occurred in quarterly profits of industrial corporations in the last five years, as indicated by reports of approximately 200 representative corporations. The index is based on rate of return so as to allow for the substantial increase in net worth that has taken place, and the year 1926 is taken as



Index of Industrial Corporation Profits, 1926 = 100, and Annalist Index of Business Activity

100. The Annalist Index of Business Activity in percentage of calculated normal is shown by the dotted line.

The iron and steel, building material, railway equipment and petroleum industries show the largest drops in profits. U. S. Steel Corporation reported net profits for the second quarter of only $7,391,000, of which all but $230,000 represented non-operating income, while in the corresponding period a year ago the net profit was $32,127,000. After allowance for dividends on the preferred stock, only 12 cents per share remained for the common, which was reduced from a $7.00 to $4.00 annual basis.

A marked reduction in manufacturing and overhead costs has been achieved during the past two years of depression and this is now beginning to be reflected in operating statements. A number of companies which in the first quarter were in the red reported a profit for the June quarter, among which might be mentioned Chrysler Corporation, Yellow Truck & Coach Manufacturing Corporation, Stewart-Warner Corporation, Westinghouse Electric & Manufacturing Co., Montgomery Ward & Co., and National Cash Register Co. General Motors Corporation's net profit in the second quarter of $55,123,000 compared with $28,999,000 in the first quarter, and was not far below the $60,964,000 reported in the second quarter last year. No less than 30 per cent of all reports published showed profits in the second quarter to be in excess of the same quarter last year.

Money and Banking

The stability of the domestic money markets has not been disturbed during July, and little of an eventful nature has occurred in them despite the critical developments which have sharply advanced rates in many foreign countries. About $26,000,000 of gold has been withdrawn by foreign countries from the Reserve System's holdings, apparently by France, but left in this country under earmark. From other nations the United States continues to attract gold, due to its position as the world's ultimate creditor, and during the month imports from Argentina and elsewhere totaled $15,000,000, reducing the net loss to $11,000,000, an insignificant amount under present conditions of superabundant credit.

The reserves of the New York City banks have continued in excess of requirements during July. This excess is directly due to the accessions of gold and the increase in Reserve bank credit outstanding during the month of June, a period of contraction in member bank loans and deposits, and constitutes the first slack to be taken up before any possibility of firmer money can be entertained.

Before the Federal Reserve System began to function, the excess of the New York City banks' reserves above legal requirements (rarely the deficit below requirements), as revealed by the weekly Clearing House statement, was the most significant banking figure available to business men. Excess reserves represented unused lending power, a margin for safety and expansion when high, and a warning of tighter money when approaching the legal minimum.

Under Federal Reserve practice excess reserves possess the same barometric significance, but are an anomaly brought about only by extraordinary conditions, and are so rare that the Clearing House no longer reports them. Having the Reserve Bank to borrow from, or to sell bills and securities to, in case of need to replenish reserves, member banks normally keep them as close to the legal minimum as possible. The present excess signifies that the amount of Reserve bank credit supplied to the market, through securities purchased on Reserve bank initiative, is greater than the immediate demands of business, and constitutes further evidence of the Reserve policy of keeping credit extremely plentiful and cheap in the hope that business revival may thereby be promoted. That the credit foundation for such revival is laid cannot be doubted, but that it is the governing factor in recovery there is yet no practical evidence.

For the System as a whole purchases of government securities totaled $79,000,000 between June 17 and July 15, by which date they apparently were terminated. At the same time Reserve bank holdings of bills purchased have been running off, and on July 29 totaled only $67,000,000, a drop of $36,000,000 in four weeks, and the lowest since July, 1929. With changes in other items, total Reserve bank credit outstanding declined slightly in the month, but not sufficiently, even in conjunction with the loss of gold, to offset the decrease in reserve requirements due to continuing declines in member bank loans and deposits. In the re-

porting member banks, deposits (exclusive of government deposits), against which reserve requirements are calculated, dropped $247,000,000 during the first three weeks of the month.

The decline in loans on securities continues a feature of the bank statements. In three weeks ended July 22 the total of such loans by the reporting member banks dropped $176,000,000. Loans to brokers reported by the New York City banks declined $89,000,000 during four weeks ended the 29th. The item of "all other" loans by reporting member banks showed some expansion during the forepart of the month, which in the apparent slackness of commercial demand may reflect the policy of the banks, dictated by the amplitude of reserves, of holding their acceptances in their own portfolios, since acceptances are included in this item.

A factor which under different conditions would make for firmer markets is the unseasonably high level of money in circulation. On July 1st, just before the period of mid-year disbursements and holiday expenditures, this item stood only $174,000,000 below the yearly peak reached last Christmas time, and at the end of the month the total was $383,000,000 larger than a year ago.

This high level reflects unsettlement created by banking troubles, which invariably cause some hoarding and the use of a larger proportion of currency in the transaction of everyday business. During June, the latest month for which figures are available, bank failures numbered 166, according to the Federal Reserve Board. This is an increase of 102 and 77, respectively, as compared with April and May, but is far below the peak of 344 reached last December. The greatest number of failures occurred in the Chicago district, and the pressing difficulties in that area now appear to have been passed.

The Bond Market

The foreign section of the bond market during the past month has reflected the shock to investment confidence caused by the European financial crisis, and by such unfavorable news as the deferment of payments on Chilean bonds, which is significant of the problems created in the debtor nations of Latin-America by shrinking Government revenues and the difficulty of obtaining foreign exchange. The decline in foreign issues has been severe, and as illustrated by representative issues of some of the countries most affected by the impairment of confidence, has been as follows:

FOREIGN BOND PRICES

	July 3	July 28	Decline
Argentine 6s, 1959	90½	75¾	14¾
Australia 5s, 1955	70¼	60⅛	10⅛
Austria 7s, 1957	87¾	70	17¾
Berlin 6½s, 1950	77⅝	56½	21⅛
Brazil 6½s, 1957	63¼	57	6¼
Buenos Aires 6s, 1961	69	52⅞	16⅛
Colombia 6s, 1961	72½	58½	14
Chile 6s, 1961	58½	37½	21
Chile Mort. Bk. 6½s, '57	60⅛	43	17⅛
Ger. Cen. Ag. Bk. 6s, '60	76½	51	25½
Germany 5½s, 1965	75	59	16
Prussia 6½s, 1951	76¾	56	20¾
Uruguay 6s, 1960	71	54	17

On the other hand, the sympathetic effects of this decline upon the obligations of those countries with respect to which confidence has not been disturbed, has been slight. Bonds representative of the credit of France, Japan and the Netherlands, among others, have held their ground firmly, and in many other cases the declines have been nominal. All of which indicates the impossibility of generalizing too readily with regard to the foreign bond market, in which averages are not as revealing as they may be in groups dominated by common conditions.

The situation in foreign bonds is evidence in some respects of the tendency of individuals to project present difficulties into the future, and to assume that bad conditions never become better, just as in the reverse situation they assume that booms will never end. We do not wish to seem to minimize the great difficulties put in the way of creditor nations by the depression, but the probability that even a substantial minority of the securities in the foregoing list will not be ultimately paid in full is unquestionably remote. Where they are the obligations of countries with sufficient resources, with industrious peoples and governments possessing the will to pay, the ability to meet the contract with bondholders, even where now properly questioned, will be regained when world business recovers. In the case of sound issues a panic price is a bargain price, and discounts of 25 to 50 per cent are so regarded in many instances by astute and discriminating buyers.

In domestic bonds trading has been dull during the month, and price fluctuations narrow. In general, the highest grade issues have maintained their position although in some cases there has been evidence of profit taking. This class of securities is favored by the likelihood that money will continue easy for some time to come.

The second-grade and speculative issues have been somewhat reactionary, demonstrating once more that their recovery will progress along with, rather than substantially ahead of, expansion of general business activity and earnings.

The Agricultural Situation

The season has now advanced to a point at which a preliminary appraisal of the crop outlook can be made. In general, 1931 promises to be a year of satisfactory harvests and unsatisfactory prices. The prospect for corn, a crop ruined by drought last year, is promising, and with sufficient moisture in dry areas production may climb to the three billion bushel mark, previously reached by only five crops in our history.

The Department of Agriculture reported on July 8 that the cotton acreage was 10 per cent smaller than last year, but prospects for a better than average yield per acre, despite reduction of 28 per cent in use of fertilizer, are considered good.

The largest winter wheat crop since 1919, with a yield per acre the largest since 1914, according to the Government's July crop estimate, is now practically harvested. Even though the Spring wheat crop, seriously damaged by drought in western North Dakota and eastern Montana, is estimated to be the smallest since 1916 and the average yield per acre the smallest since 1919, total wheat production is placed by the Government at 869,000,000 bushels, which is 47,000,000 above the 1925-29 average. Continuing the adjustment of the United States price to the world level, which itself has declined further, quotations for wheat in Chicago dropped during July to the lowest figure in the life of the Board of Trade. The extreme declines have aroused interest in historical price records, which in England include yearly averages going back nearly seven centuries. The low in Liverpool during July was equivalent to approximately 55 cents per American bushel, and was the lowest recorded since the year 1592. The bottom was 9 cents, in 1287 and 1288.

Farm Board Policies

Liverpool is a world market for wheat, registering the offerings from many lands, and buying from whichever offers cheapest. During much of the past crop year the United States markets were supported above an export parity through operations directed by the Federal Farm Board. Maintenance of this situation having become impossible by reason of mounting stocks and accumulating carrying charges, and the ineffectiveness of price pegging as a remedy for the growing surplus having been conclusively demonstrated, those operations were discontinued during June. As a result prices at the Gulf ports of wheat from nearby territory, which is in such heavy supply that it is being piled upon the ground, have now declined to an export basis. While the Kansas City and Chicago markets are still high as compared with Liverpool, the readjustment of port prices to the world level is distinctly encouraging, and lays the groundwork for the only possible solution of the surplus problem.

The interest of the Farm Board in the market is now limited to the disposition of the wheat accumulated, which stocks constituted the major share of the domestic carryover on July 1. In response to demands that it adopt a definite policy with regard to these stocks, the Board announced on June 30 that it would limit its sales between July 1, 1931, and July 1, 1932, to a cumulative maximum of 5,000,000 bushels a month, except for foreign contracts under negotiation. This limitation, it will be noted, sets a maximum, not a minimum, and the Board further stated: "It is not the purpose to make any immediate sales even of these limited amounts at the present range of prices." But this announcement is unsatisfactory to wheat growers who are receiving only 25 cents or thereabouts for their grain in the interior, and who urge that the Board should either withhold 1930 wheat from sale entirely this year, or release it only at a price considerably above the current market.

The complaints are understandable, and have the great force of economic distress behind them. But an orderly reduction of the Farm Board's stocks, as soon as may be, is desirable for the same reasons which governed the withdrawal of the pegged price, and the Board holds that it should avoid pledges which would prevent it later from selling as demand may arise, or from reshaping its policy according to changes in the situation, such as might readily occur in the case of crop failure elsewhere in the world. The whole controversy, which is finding its way into politics again, illustrates the inescapable disturbing effects of Government participation in the markets. The public character of such participation makes everyone feel entitled to a voice in its policies, which is not conducive to economically wise decisions, and the interference with impersonal economic influences introduces incalculable factors into the market which are alarming to other buyers and sellers, and thus tend to disrupt trade.

The Wheat Position

The United States has a round half billion bushels of wheat available for export and carryover this year, the cumulative surplus of the past five years. The figures are as follows:

Wheat Situation in the United States
(Millions of Bushels)

	1930-31	1931-32 (Estimate)	Change
Crop	863	869	+ 6
Carryover	275	300	+25
Total Supply	1,138	1,169	+31

Wheat Situation in the United States
(Millions of Bushels)

	1930-31	1931-32 (Estimate)	Change
Home Consumption incl. seed requirements	585	585	——
Used as cattle feed	140	80	—60
Left for export and carryover	413	504	+89
Actual exports	115		

For the world as a whole, the relations between exportable supplies of wheat and the deficits of importing countries seem similar to a year ago. In the chief importing countries crops of wheat and other cereals appear to be somewhat better than last year, and now that their own crops are moving they are reducing again the percentages of foreign wheat they allow to be milled. But production in the exporting countries outside of the United States, while still partly a matter of conjecture, promises to be considerably smaller.

The total world supply, including carryover and new crops, may be 200,000,000 bushels smaller, according to tentative estimates made by the Bureau of Agricultural Economics. The figures used by the Bureau are as follows:

World Production and Supply of Wheat
(Millions of Bushels)

Crops	1930-31	1931-32	Change
U. S. and Canada	1,261	1,104	—157
Europe outside Russia	1,371	1,421	+ 50
Other Northern Hemisphere	664	634	— 30
Southern Hemisphere	496	......	
Russia	1,084	......	
Total	4,876		
Carryover	554	620	+ 66
Total Supply	5,430	5,230*	—200*

*Including allowances based on acreage and average prospects for Russia and the Southern Hemisphere, for which no estimates are yet available.

Despite the indicated reduction in supply, prices are almost 40c lower than in July, 1930. Last year the markets required nearly three months to learn and face the fact that Russia had reappeared as a wheat exporter. This year they are more awake to the Russian competition, and in consequence the speculative interest is reduced.

There is no mystery about the wheat situation. The world has too much wheat for market demands. There is always room for futile argument as to whether a surplus is due to over-production or under-consumption, but the world is producing more wheat annually than ever was annually consumed, and the carryover July 1, 1931 was the largest ever known. The attempt of the Federal Farm Board to maintain the price of wheat in this country in the face of falling prices in world markets had the effect of transferring a part of the loss upon the 1930 crop from the producers to the government treasury, but it encouraged the maintenance of production in this country upon an imprudent scale. The policy could not be continued and the loss to growers has come this year instead of last. The wheat markets will recover whenever they are rid of the heavy surplus which is depressing them, and when all arbitrary influences are eliminated, so that the law of supply and demand will have free play. After all that has been said about the ill-effects of speculation in grain, there is now afforded a very clear demonstration of the results of absence of speculation.

Russia the Enigma

Russia remains and will continue for some time a factor of great uncertainty. The area seeded to wheat for this crop is officially stated to be 94,100,000 acres, an increase of 10,300,000 over last year, but the trade assumes that the yield per acre will be less than the abnormally high 1930 figure. As a generality, it is doubtless true that in the semi-arid areas from which Russia's export wheat is drawn wide fluctuations in the crop are inevitable, as in the dry areas of western Canada, but thus far reports of prospects are not very definite. However, ship charterings for grain movement out of the Black Sea indicate that Russian exports will be heavy this year. The "exportable surplus" of Russia is dependent not wholly upon her production, but upon the arbitrary decisions of the Central Planning Board and the Government, and despite the rationing of food within the country, it seems that under the present regime she will continue to export wheat to pay for the large imports she needs.

Mr. I. E. Lubimov, Assistant Commissar for Foreign Trade, has stated that domestic consumption last year was about 860,000,000 bushels. Deducting seed requirements, this is a per capita consumption of 4.8 bushels, to which may be added an approximately equal quantity of rye. This is very little, considering that wheat and rye are still the staples of sustenance in Russia; diversification of diet as in this country or even in Western Europe is unknown and impossible. Therefore Russia probably could consume at home all the wheat and rye now produced.

On June 23 Stalin delivered a speech to the central committee of the Communist Party which was hailed as the beginning of a new economic era. Impressed by the necessity of increasing the efficiency of workers by raising their standard of living, he promised among other things allocation of a larger share of the output of goods to the home population; and opening of several hundred additional food stores has been ordered. Such a shift in Russian policy, which has been directed to building up capital equipment at the expense of living standards, is expected to come at one time or another by all observers, but it is manifestly impossible to pre-judge its influence on the wheat situation when not even the supply is known.

Effects of Depression

There can be only one measure of agricultural improvement, a rise in profit. The depression assists in reducing production costs, which is one element in profit, but for the present prices dominate the situation. On no section of the population have the effects of price declines fallen more severely than upon the farmer, since commodities of primary production dropped earliest and most rapidly. A suggestion for a moratorium upon certain farm debts has been advanced, the proponents evidently overlooking the fact that in deserving individual cases renewal of debts under present conditions is a common practice and a matter of necessity, while any general compulsion to that effect would be subversive of credit and thereby penalize the farmer, who requires credit, most of all. It would have effects upon a chain of creditors which do not seem to be even faintly realized, since these creditors themselves have debts, and in the case of land bank bonds many fiduciary relationships are involved.

Unless prices recover substantially the gross farm income this year will be lower than last. Costs will be reduced but not in proportion to the reduction in prices, except where better yields per acre are achieved. As compared with a year ago, the latest figures of the Department of Agriculture of prices received and paid by farmers in percentages of 1910-14 averages, show the following changes:

	June 1930	June 1931	Percent Change
Prices Received by Farmers	123	80	—34.9
Prices Paid for Commodities Bought	149	130*	—12.7
Farm Purchasing Power (ratio of prices received to prices paid)	82	61*	—25.6
Farm Labor Demand, per cent of normal	83.9	72.6	—13.4

(*) Preliminary.

The showing upon the whole conveys little promise of special stimulation to general business activity this Fall, unless a major crop failure should occur outside of the United States, and bring to this country an unexpectedly large export demand. It is nevertheless true that even at low prices the movement of large crops produced at low cost is a valuable supporting factor, productive of seasonal expansion. This support was notably reduced during the last crop year on account of the damage done by drought, and it is not too early to conclude that within the broad area affected by that drought conditions during the coming Fall will be much more favorable.

Deferment of Payment on Chilean Bonds

Chile, a country which during 89 years had promptly paid interest and principal on its debts, and as promptly met sinking fund requirements except in wartime in 1880-83, during the past month has deferred payments currently due abroad on public obligations, and her economic difficulties have culminated, as in a number of other South American countries, in an overturn of government. After several days of unsettlement and successive changes of cabinet, Carlos Ibanez, President since 1924, fled the country July 26th. Pending a general election the provisional government is now headed by Juan Esteban Montero as acting President, and Pedro Blanquier, who had resigned as Premier and Minister of Finance on July 21st, has reassumed the latter office.

On July 16th the government, Senor Blanquier being Premier at the time, made formal announcement that payment of service on foreign obligations could not at present be made in foreign currency, and that the amounts due to be remitted abroad prior to August 1st would be deposited in Chilean currency in the Central Bank of Chile. Formulation of the policy to be followed after that date has been delayed by events, and was, at this writing, still to be announced. The desire of the new government to keep faith with its creditors is not in question, and its personnel supplies assurance that its endeavors to solve the country's economic problem will be soundly conceived and able in execution.

In explanation of the necessity for its decision, the government made the following statement:

> Chile, as many other countries, has been severely affected by the world crisis. Due to the diminution of its exports, the trade balance is unfavorable and the Banco Central has seen its reserves and gold deposits abroad gradually diminish. The Government has the firm resolution of maintaining the stability of its money in the interest of the domestic business of the country as well as of foreign creditors, for which it must see that the reserves of the Banco Central are conserved. Under the present circumstances the situation of the Banco Central would be seen gravely affected if the Government should have recourse to this institution to obtain the drafts necessary for the purpose of continuing to pay the service of the external debt in foreign money, drafts which at this time are not found on the market in sufficient quantity due to the diminution of exports. The Government does not ask the suspension of those payments which it recognizes as due; but it has resolved that, in its opinion, it will protect its monetary situation and the holders of its bonds abroad, paying the service of its consolidated debt during this month by depositing the amount in legal money in a special account in the Banco Central of Chile.
>
> At the same time the Government is studying strong economies which it will put into practice immediately, and which will permit it to present later on the manner in which it will continue to effect these payments monthly from the first of next August.

The interest and amortization payments due to be made to bondholders on August 1st, and affected by this decision, totaled about $962,500 in New York, and £82,000 in London. The total annual requirement for interest and amortization payments on the external funded public debt is approximately $40,567,000. A loan of $10,000,000 to the Mortgage Bank,

guaranteed by the government, falls due on December 31st next. Thus the total amount necessary to be remitted for payment to bondholders abroad during the next twelve months, for which foreign exchange will be required, is in round sum $50,000,000. A floating debt that totaled approximately $60,000,000 on April 1st last, owed in New York and London, is another element in the government's problem. The funded debts themselves totaled $457,000,000 on December 31, 1930, of which $284,000,000 was issued in New York and $149,000,000 in London.

The difficulties of Chile are illustrative in general of the worldwide effects of the depression, and in particular of the problems of a debtor nation whose trade is diminished gravely by world disorder and the decline in prices. The first necessity of a nation owing external debts is to collect within the country the funds with which to pay; the second is to transfer these funds to the creditor nation in the latter's own currency. Business depression interferes in both respects. It diminishes the government revenue, the fund out of which the service of public debts is paid; and unless goods can be sold abroad in excess of goods purchased, and credit balances created out of which to make payments, the transfer of the funds can be accomplished only in gold, or by further borrowing from creditor countries.

Declines in Revenues and Trade

In both revenues and trade balances Chile has suffered from the decline in foreign demand for her products. During 1927-29 inclusive the ordinary budget yielded a surplus each year, but during 1930 a deficit of $9,000,000 resulted from the falling off in revenues, and it has been officially stated that the deficit for the present year will reach $18,000,000.

The reversal of the trade balance has been even more striking and more important in the situation. In 1927-29 the average annual excess of exports was more than $80,000,000, but in 1930 exports declined $118,000,000 under 1929, and as imports were reduced only $28,000,000, the trade balance was converted into an import excess of $8,500,000. The difficulty of procuring foreign exchange under such conditions was partially met by obtaining loans, both for short and long terms, which created credit balances abroad; at the same time gold reserves were drawn upon, and the item of gold and sight deposits abroad of the Central Bank of Chile showed a reduction of nearly $20,000,000, or more than a third, between January 31, 1930 and the same date in 1931.

Thus far in the present year imports have been reduced more sharply, offsetting a further decline in exports, and for the first four months a favorable trade balance of about $3,200,000 is reported. In addition the Government was paid the major part of $21,900,000 due from the Nitrate Corporation of Chile—"Cosach"—a consolidation embracing virtually all producers. The Government owns half of the shares of this corporation and in lieu of export taxes is guaranteed a minimum income through 1933. This payment was made out of the proceeds of a loan floated abroad. Private investments in Chile provided further limited amounts of foreign exchange. The gold reserve was again drawn upon to the extent of some $12,000,000 between January 31st and July 10th, reducing the item to $27,000,000 and the legal reserve ratio to 59.9 per cent, compared with the legal minimum of 50 per cent.

Foreign Exchange Gradually Exhausted

By such means payments due were made during the first half of this year, but available resources for the purchase of foreign exchange were gradually exhausted. The flow of private investment capital into the country has dwindled to nothing, incident to the slowing down of enterprise everywhere while the world catches up to the capacity of the plant it has already constructed. Prices of Chilean bonds preclude public flotations of loans abroad. Any further depletion of gold reserves below present figures could not meet the need for exchange for long, and would be against the interest of both Chile and its creditors by draining the base of the country's currency and bank credit. Thus it is in the direction of a larger favorable balance of trade that the eventual solution of the problem needs be sought, emphasizing once again the fact that the basic remedy for disordered world finance is in the restoration of trade and of conditions that will promote it.

Chile is notably rich in resources. The basis of the national economy is largely the production and export of minerals, notably nitrate and copper, which together make up some 80 per cent of her exports. The decline in shipments of the two commodities from 1929 to 1930 was, in value, 39 and 51 per cent, respectively.

Both with respect to government revenues and the trade balance, the situation outlined is comparable to that of an individual who suffers reverses which leave his outgo in excess of his income. Economies and savings are projected by Senor Blanquier, and effectively carried out will tend to restrict imports and thereby to achieve a more favorable trade balance, as well as build up net revenues and assist in maintaining confidence abroad in an eventual satisfactory outcome of this troublesome period, during which the exchange problem is so difficult of solution.

Combined Statement of the Banks of the First National Group in Minneapolis

as at June 30, 1931

RESOURCES

Loans and Discounts	$ 59,152,540.68
Overdrafts	14,012.11
U. S. Govt. Securities	20,180,042.54
Other Bonds & Securities	26,734,522.48
Bank Buildings	1,166,500.00
Furniture & Fixtures	123,510.88
Customers' Acceptance Liability (Less Anticipations)	836,053.17
Bankers, Acceptances Purchased	2,427,911.41
Interest Earned but not Collected	431,541.36
Cash on Hand & Due from Banks	43,127,085.67
	$154,193,720.30

LIABILITIES

Capital Stock	$ 7,500,000.00
Surplus	6,081,000.00
Undivided Profits	839,537.36
Reserve for Interest, Expenses and Taxes	456,706.81
Interest Collected but not Earned	239,823.20
Circulation	2,001,000.00
Letters of Credit and Acceptances	836,053.17
DEPOSITS	136,239,599.76
	$154,193,720.30

Affiliated with

FIRST BANK STOCK CORPORATION

FIRST NATIONAL GROUP

ST. ANTHONY FALLS OFFICE
East Hennepin at 4th Street
WEST BROADWAY OFFICE
West Broadway at Emerson
NORTH SIDE OFFICE
Washington at West Broadway
HENNEPIN STATE BANK
Washington at Hennepin

FIRST NATIONAL BANK
THE OLDEST BANK IN MINNEAPOLIS-ORGANIZED 1864
FIRST MINNEAPOLIS TRUST COMPANY
ORGANIZED 1888
FIRST SECURITIES CORPORATION

MINNEHAHA NATIONAL BANK
27th Avenue South at Lake
PRODUCE STATE BANK
1st Avenue North at Seventh Street
BLOOMINGTON-LAKE NATIONAL BANK
Bloomington at Lake

Affiliated with
FIRST BANK STOCK CORPORATION

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